

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

WILLIAM L. REED

CASE NO. 00-65582

Debtor

Chapter 13

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

**MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER**

Under consideration by the Court is the Third Amended Chapter 13 Plan ("Plan") filed by William L. Reed ("Debtor") on February 27, 2002. Opposition to the Plan was filed by Mark

Swimelar, Esq., the chapter 13 trustee (“Trustee”), on April 2, 2002.¹

The confirmation hearing to consider the Debtor’s Plan was held on April 9, 2002, at Binghamton, New York. The Court acknowledged the prior objection filed on behalf of Manufacturers and Traders Trust Company (“M&T”), which had been taken under submission following an evidentiary hearing conducted on July 26, 2001 (“July Hearing”).²

The Court agreed to take the matter under submission following the hearing on April 9, 2002.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of this contested matter pursuant to 28 U.S.C. §§ 1334, 157(a), (b)(1) and (b)(2)(L) and (O).

FACTS

The Debtor filed a voluntary petition pursuant to chapter 13 of the Bankruptcy Code, 11 U.S.C. §§ 101-1330 (“Code”) on November 13, 2000. Debtor is employed by Extended Stay

¹ The Internal Revenue Service (“IRS”) withdrew its previous objection to the Debtor’s Second Amended Chapter 13 Plan upon agreement with the Debtor that it would receive full payment on its priority claim in the amount of \$19,716. *See* Letter from William F. Larkin, Asst. U.S. Attorney, dated February 28, 2002.

² In a letter dated February 8, 2002, and addressed to Debtor’s counsel, Leslie N. Reizes, Esq., the Court had indicated that it would not render any decision on the feasibility issue which was the subject of the July 26, 2001, hearing until the Debtor had addressed certain “infirmities” in the Second Amended Plan. Those issues concerning feasibility will be addressed herein.

America Management, Inc. (“ESA”) to develop real estate parcels on which to construct hotels. Debtor testified at the July Hearing that he is involved with the zoning and planning for the real estate parcels and oversees the construction of the hotel before turning it over to the company to operate. At the time of the July Hearing, he testified that he earned \$86,500 per year. His net monthly take home pay is \$4,924.34. *See* Debtor’s Amended Schedule I, filed August 17, 2001. Prior to joining ESA in September 2000, he was in the mortgage origination business and also had experience developing properties for other developers. His monthly expenses, including expenses associated with certain rental property owned by him, total \$12,356. *See* Debtor’s Amended Schedule J, filed August 17, 2001.

Debtor’s wife has been employed for approximately ten years as Director of Career Services at the School of Hotel Administration, Cornell University.³ Her net pay on a semi-monthly basis totals \$1,530.69 or \$3,060 per month. *See* Debtor’s Exhibit 4. At the hearing on April 9, 2002, Debtor’s counsel represented that the Debtor’s spouse would be contributing to the payment of the expenses listed in Debtor’s Amended Schedule J.

Debtor and his wife reside at 162 Genung Road, Ithaca, New York (“Residence”). The Residence is appraised at \$249,000. *See* Debtor’s Exhibit 1. M&T filed a proof of claim on March 12, 2001, in the amount of \$299,395.76 in connection with its mortgage on the Residence. Debtor testified that there is an apartment located above the garage at the Residence for which the Debtor receives rent of \$380 per month.⁴ According to the Debtor, the monthly payments to

³ Debtor’s wife filed a voluntary petition pursuant to chapter 7 of the Code on July 12, 2001. *See* Debtor’s Exhibit 6.

⁴ At the time that the Debtor filed his petition, on November 13, 2000, he was not the titled owner of the Residence. According to his wife’s petition, she transferred her interest to the

M&T on the Residence total \$2,600.

In addition to his employment with ESA, the Debtor also owns certain commercial real property.⁵ He owns a four unit apartment complex at 1065 Dryden Road, Ithaca, New York (“Fourplex”), which is appraised at \$201,000. *See* Debtor’s Exhibit 2. According to the proof of claim filed by M&T on March 12, 2001, the indebtedness on the Fourplex pursuant to its mortgage is \$301,455.56. When fully rented, the Debtor testified that the Fourplex generates approximately \$3,200 per month in income.⁶ Expenses on the Fourplex, including water and sewer (\$1,400), real estate taxes and insurance (\$6,100), management fees (\$2,700), maintenance (\$3,500) and miscellaneous (\$400) total approximately \$14,100 per year or \$1,175 per month, without taking into account the mortgage payment to M&T of \$2,400 per month.

The Debtor acknowledges that at the time he filed his Petition in November 2000, he was six months in arrears on both mortgages. The Debtor’s Plan provides for monthly payments of \$153.34 for 60 months for distribution to the unsecured creditors in Class 5 by the Trustee. It is estimated that the payments will provide a dividend of 2.5%. The Debtor reached an agreement with the IRS to pay its priority claim in full. The Plan provides at ¶ 3 that monthly payments on the IRS’ claim will be made over 60 months in the amount of \$328.63 per month through the Plan.

Debtor on March 12, 2001. *See* Debtor’s Exhibit 6. She also transferred a half interest in the Fourplex to the Debtor in June 2000. *See id.*

⁵ The Debtor testified that he owns an interest in two properties in Ithaca, New York, with a couple of other individuals, which he viewed as long-term investments. He derives no income from the properties currently or from the partnership that manages one of the two properties. He also testified that at present there is no equity in either of the two properties.

⁶ According to the Debtor’s Federal tax returns, monthly rental income from the Fourplex totalled approximately \$3,035 in 1998, \$3,083 in 1999 and \$3,071 in 2000.

However, at ¶ 5(a) it is stated that

Class 1 claims other than administrative expenses (which includes the claim of the IRS) shall be paid through the trustee to the appropriate taxing authority in 60 equal monthly installments, without interest, and within the Plan. Administrative expenses shall be paid in full at confirmation.

The Trustee has objected to this provision to the extent that if the Debtor intends to pay the IRS' claim at confirmation from cash on hand, the monies should first be turned over to the Trustee. *See* Trustee's Objection, filed April 2, 2002.

The Plan also provides for various payments to secured creditors to be made outside the Plan. At the hearing on April 9, 2002, the Debtor agreed to make the payments through the Trustee, with the exception of the balloon payments to be made on the Residence and the Fourplex to M&T at the end of the 60 months. The Debtor proposes to cramdown both of M&T's mortgages and to pay the secured portion, based on the appraisals submitted by the Debtor, over five years, amortized over 30 years at an interest rate of 5.70%, with a balloon payment five years from the date of filing of the Petition, or November 13, 2005.

At the July Hearing, the Court requested, *inter alia*, that the Debtor file projections of the income and expenses on the "Fourplex" going out 5 years.⁷ According to the Projections, Debtor estimates rental income of \$3,450 per month during the first year, beginning August 2001 or a

⁷ On August 17, 2001, the Debtor filed the affidavit of Kathleen Vanderbilt, president of A.K. Properties, Inc., the property manager of the Fourplex, sworn to August 15, 2001 ("Vanderbilt Affidavit"). Attached to the Vanderbilt Affidavit is a copy of the five year projections ("Projections") requested by the Court, which it will consider. The Court will not consider the balance of the Vanderbilt Affidavit concerning valuation estimates on the Fourplex. Ms. Vanderbilt was not available as a witness at the evidentiary hearing and M&T has not been afforded an opportunity to cross-examine her. For the same reason, the Court will not consider the Loan Amortization Table setting forth the schedule of payments at an annual interest rate of 5.70%, which was included with M&T's memorandum of law on August 29, 2001.

total of \$41,400.⁸ Expenses are estimated to be \$24,060 over the first year and Debtor estimates a vacancy factor of 5% or \$2,070 and a reserve of 10% or \$4,140. According to the Debtor's projections, the net income available for debt service for the year beginning August 2001 - July 2002 totals \$15,270, which the Debtor estimates will increase 3% for year 2, and 2% for years 3-5. The Debtor estimates debt service for the first year to be \$11,457, calculated at an interest rate of 5.7% on \$201,000. M&T disputes this amount, alleging that Debtor only accounts for the payment of interest and that the actual yearly amount of payment on both principal and interest at a rate of 5.7% is \$13,927.20 or approximately \$2,500 more than the Debtor estimates in debt service.

In connection with the Debtor's proposed balloon payment on M&T's mortgages at the end of five years, the Court heard testimony from Edward Kelly ("Kelly") as an expert with respect to the "non-conforming" mortgage business. He testified that there are lenders who will grant mortgages to individuals who have obtained a chapter 13 discharge after completion of their plan payments. Whether or not an individual qualifies for a loan will depend on the credit score. The credit score in turn is based on the individual's payment record, the amount of outstanding debt and the individual's income. The lender, in deciding whether to underwrite the loan, will examine not only the credit score, but also the value of the real property and the amount of equity in it. Kelly testified that property containing more than four units is deemed to be commercial property. Because the Debtor's property at 1065 Dryden Road consists of four units, it would

⁸ A review of the figure identified as "Total Revenue" for the first year, on which all other years are based, reveals that in calculating the revenue the computer incorrectly added in "2001" and "2002" in the months of August 2001 and January 2002 to the regular monthly rental amount of \$3,450. However, the calculation for the total year of 2001-2002 of \$41,400 appears to be correct.

qualify for a residential mortgage. It was Kelly's testimony that lenders would prefer to have up to a 20% equity position or an 80% loan to value ratio for a conforming loan. However, he acknowledged that he had seen it go as high as 90% loan to value ratio on a conforming loan, and non-conforming loans are frequently made with a 90% loan to value ratio as well. As Kelly explained, his company would not be willing to make a loan for anything more than 90% of the value of the real property.

The non-conforming rates, according to Kelly, currently range from 9% for 5 year loans years to 10-10.5% for 30 year loans. This compares to interest rates of 6.5% for 5 year conforming loans and 7.375% for 30 year conforming loans.

DISCUSSION

Code § 1325(a)(6) requires that the Court determine whether the Debtor will be able to make payments under the Plan. 11 U.S.C. § 1325(a)(6). This determination is measured by whether the Debtor's Plan has a reasonable likelihood of success, and it is the Debtor's burden to show that he "has the present as well as the future financial capacity to comply with the terms of the Plan." *In re Fantasia*, 211 B.R. 420, 423 (1st Cir. BAP 1997) (citation omitted). Because the Debtor proposes to make a final balloon payment, the necessity of demonstrating that the funds will be available at the time the payment is due is particularly critical. *Id.*; *see also In re Wagner*, 259 B.R. 694, 700 (8th Cir. BAP 2001) (requiring that there be "[a] definite declaration as to the source and the amount of funds necessary to enable the debtor to make the plan payments . . .").

The Court has several concerns regarding the feasibility of the Debtor's Plan as currently proposed. At a minimum, the Plan proposes that the Debtor make payments of \$153.34 over 60 months to the Trustee for distribution to the unsecured creditors. According to ¶ 3 of the Plan, the Debtor is also proposing to pay \$328.63 per month on the IRS's priority claim over 60 months although there is some question as to whether he actually intends to pay it upon confirmation. An examination of the Debtor's schedules reveal monthly expenses of \$12,356 and monthly income of \$8,624.34. His wife's monthly net income totals \$3,060.⁹ Based on the documents filed with this Court, the Debtor's income, when combined with that of his spouse, totals \$11,682.34. This amounts to a negative disposable income of \$673.66. Accordingly, the Debtor has insufficient income to make his monthly payments to the Trustee, whether they be \$153.34 to the general unsecured creditors or the additional \$328.63 to the IRS, making the Debtor's Plan unfeasible.

The Court deems it appropriate to address other issues of feasibility raised at the July Hearing given the fact that the Debtor's case was filed in November 2000 and the Debtor has yet to confirm a plan in approximately 18 months. The first such issue involves the appropriate rate of interest to provide M&T with the present value of its secured claim of \$201,000 on the Fourplex and \$249,000 on the Residence.

The Court of Appeals for the Second Circuit in *In re Valenti*, 105 F.3d 55 (2d Cir. 1997) indicated that the appropriate rate of interest to be applied to afford a secured creditor with the present value of its claim is "the rate on a U.S. Treasury instrument with a maturity equivalent to

⁹ According to Schedule I, filed with her petition, her monthly net income is \$3,018. Supplemental Schedule I, filed in this case on February 5, 2001, with respect to her income shows monthly take home pay of \$3,058. For purposes of this discussion, the Court will use the figure of \$3,060, as listed on her pay stub for the week ending July 15, 2000. *See* Debtor's Exhibit 4.

the repayment schedule under the debtor's reorganization plan." *Id.* at 64. The Court of Appeals also held that a range of one to three percent was appropriately added to the "market rate of interest" to account for "the risk to the creditor in receiving deferred payments under the reorganization plan." *Id.* (citations omitted).

M&T contends that the interest rate of 5.70% proposed by the Debtor does not adequately compensate it over the life of the Plan. The proposed interest rate of 5.70% includes a risk factor of 1% over and above the rate for Treasury bonds with a maturity of five years of 4.70%, *see* Debtor's Exhibit 3 and M&T's Exhibit A. The Court concludes that it would be appropriate to add an additional percent due to the fact that not only is M&T being asked to assume a risk in the form of deferred payments under the Plan from a Debtor who has a history of default, but it is also being asked to assume a risk in the form of a final balloon payment on both mortgages. Accordingly, the Court concludes that the appropriate rate of interest should be 6.70% on the claims of M&T secured by the Residence and the Fourplex.

The question of the Plan's feasibility to pay the debt service is also of concern. According to the Debtor's Projections, the net revenue from rentals at the Fourplex for the period from August 2001 until July 2002 (first year) is expected to total \$15,270, after subtracting expenses of \$24,060, an allowance for vacancies of \$2,070 based on 5% of \$41,400 (gross revenues) and a figure of 10% or \$4,140 for reserves. According to M&T, the Debtor would have to make monthly payments of \$1,297.01, or \$15,564.12 per year, at a rate of 6.70% on a claim of \$201,000.¹⁰ *See* Supplemental Memorandum, filed August 29, 2001. While the Court has no

¹⁰ For purposes of this decision, the Court will limit its discussion to the feasibility of the Debtor's Plan insofar as it proposes to pay M&T on its mortgage covering the Fourplex since that was the primary focus of the evidence submitted to the Court at the July Hearing.

evidence to support the amount of monthly payments required when the interest rate is 6.70%, it does have evidence of the payments when the interest rate is 6.50%. *See* M&T's Exhibit C. According to the loan amortization table for an interest rate of 6.50%, payable over 60 months, the monthly payment would be \$1,270.46 or \$15,245.52 per year.¹¹ This represents a difference of approximately \$25 between the amount of net income (\$15,270) and the amount of debt service (\$115,245) at the lower interest rate of 6.50%. Thus, it is clear to the Court that the Debtor's Plan, based on the Projections presented to the Court, is unfeasible in that the Debtor's estimated revenues will be insufficient to cover the debt service beginning in the first year of the Plan at an interest rate of 6.70%.

The final issue for the Court concerns the feasibility of the Debtor's Plan with respect to the proposed final balloon payment. The courts to have addressed the issue have agreed that a plan may provide for a final balloon payment. *See In re Cloud*, 209 B.R. 801, 809 (Bankr. D. Mass. 1997) (noting that "[t]he majority of courts does not reject balloon payment plans as unfeasible *per se* and instead carefully scrutinizes plans with balloon payment provisions on a case-by-case basis, reviewing a plan's feasibility based upon the totality of the circumstances." (citations omitted)).

The Debtor is proposing to make balloon payments on M&T's two mortgages by means

¹¹According to the Projections based on 5.70%, the Debtor anticipated paying \$11,457, or \$955 per month, in debt service over the five years of the Plan. Based on its own calculations ($\$201,000 \times .0570$ divided by 12 months/year = \$955 in interest/month), the Court finds that the figure used by the Debtor does not include any payment of principal. Yet, in order to obtain refinancing, it is critical that the Debtor reduce the principal balance on M&T's claim during the five years of the Plan. *See Wagner*, 259 B.R. at 701 (noting that among the factors to consider in determining the feasibility of a plan where there is a balloon payment proposed is "whether the plan provides for payments to the creditor which will significantly reduce the debt and enhance the prospects for refinancing at the end of the plan." (citations omitted)).

of refinancing. As Kelly testified, in order to obtain such refinancing the Debtor will have to establish a good payment history throughout the term of the Plan, including his payments to M&T on the two mortgages. Whether or not he will be able to obtain refinancing will also depend on the value of the real property in November 2005 and the amount of equity he has after completing his payments on the mortgages over the 60 months pursuant to the Plan. Kelly also testified that in order to obtain refinancing, the key would be a 90% loan to value ratio.

As discussed above, at the 6.70% interest rate, there are insufficient monies to cover the debt service over the next five years. There is also no evidence in the record to indicate the amount that the Debtor intends to borrow in November 2005 in order to make the balloon payments on both of M&T's secured claims or the estimated value of either the Debtor's Residence or the Fourplex at that time. At this stage of the proceedings and based on the evidence presented to it, this Court concludes that the Debtor has failed to meet his burden of establishing that the Third Amended Plan is feasible.

Based on the foregoing, it is hereby

ORDERED that confirmation of the Debtor's Third Amended Plan be denied.

Dated at Utica, New York

this 15th day of May 2002

STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge